

Message Text

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ACTION EUR-12

INFO OCT-01 EA-09 NEA-10 ISO-00 AID-05 CIAE-00 EB-07
FRB-01 INR-07 NSAE-00 USIA-15 XMB-04 OPIC-06
SP-02 LAB-04 EPG-02 SIL-01 OMB-01 NSC-05 SS-15
STR-04 CEA-01 L-03 H-02 PA-02 PRS-01 INT-05
FEAE-00 ARA-10 AF-10 AGRE-00 /145 W
-----031658Z 056430 /42

R 031628Z JUN 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 4701
TREASURY DEPT WASHDC
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
AMEMBASSY NEW DELHI
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
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DEPARTMENT PASS FEDERAL RESERVE BOARD

TREASURY FOR DONALD E. SYVRUD' OASIA

E.O. 11652: N/A
TAGS: ECON, UK
SUBJECT: NIESR FORECAST AND APPRAISAL OF THE U.K. ECONOMY

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1. SUMMARY: THE NATIONAL INSTITUTE OF ECONOMIC AND SOCI-
AL RESERACH (NIESR) HAS PUBLISHED THE LATEST OF ITS THRICE
ANNUAL FORECASTS AND APPRAISALSO OF THE U.K. ECONOMY. IT
FORESEES SLOW GROWTH WITH A BALANCE OF PAYMENTS SURPLUS
OVER THE NEXT TWO YEARS. A TIGHT INCOMES POLICY CONTINUES
TO BE THE CENTRAL TENET OF ITS POLITICAL ECONOMY. END
SUMMARY.

2. NIESR PRESENTS THREE FORECASTS IN THIS ISSUE OF ITS REVIEW. TO CORRESPOND TO INCREASES IN AVERAGE EARNINGS OF 10. 15. AND 20 PERCENT. THE THREE LEVELS OF AVERAGE EARNINGS GROWTH CORRESPOND TO NIESR'S ESTIMATE OF TIGHT. MODERATE AND INEFFECTIVE INCOMES POLICIES. THE FORECAST CORRESPONDING TO A 15 PERCENT AVERAGE EARNINGS GROWTH IS ACCEPTED AS A CENTRAL FORECAST AND IS SUMMARIZED AS:

REAL

PERSONAL UNEMPLOY- MONEY

REAL GDP DISPOSABLE MENT(A) SUPPLY

(PERCENT INCOME (FOURTH (PERCENT

CHANGE. (PERCENT QUARTER. CHANGE,

YEAR/YEAR) CHANGE. MILLION) YEAR/YEAR)

YEAR/YEAR)

1976 1.2 - 0.5 1.3 11.3

1977 1.5 - 2.2 1.4 7.9

1978 2.3 1.9 1.6 14.0

CONSUMER

PUBLIC SECTOR

PRICES CURRENT BORROWING

(PERCENT ACCOUNT REQUIREMENT

CHANGE BALANCE (YEAR, (FISCAL YEAR,

YEAR/YEAR) POUNDS BILLION) POUNDS BILLION)

1976 15.2 - 1.4 8.8

1977 14.5 0.4 6.0

1978 10.5 1.3 5.1

(A) - GB. SEASONALLY ADJUSTED, WHOLLY UNEMPLOYED. EXCLUD-

ING SCHOOL LEAVERS AND ADULT STUDENTS.

MORE COMPLETE TABLES FOLLOW BY AIRGRAM

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THE CREDIT EXPANSION TARGETS OF THE IMF ARE ASSUMED MET, AS WELL AS THE GOVERNMENT'S MONEY SUPPLY GROWTH TARGET OF 9 TO 13 PERCENT. THE EXCHANGE RATE IS SET AT CURRENT LEVELS FOR THE PURPOSE OF THE FORECAST ALTHOUGH UPWARD PRESSURE IS PREDICTED OVER THE FORECAST PERIOD. NIESR FEELS THAT IT WILL HOWEVER, BE NECESSARY TO ENGINEER AN INCREASE OF LONG-TERM INTEREST RATES TO AROUND 14 PERCENT BY THE END OF 1977 TO CUT OFF THE DEMAND FOR FUNDS AND HENCE THE EXPANSION OF THE MONEY SUPPLY. IT IS BELIEVED THAT AT THIS HIGHER LEVEL. THE SALE OF GILTS WILL BE SUFFICIENT TO HOLD THE MONEY SUPPLY IN CHECK. MANUFACTURING INVESTMENT IS FORECAST TO INCREASE BY 15 PERCENT IN 1977 AND 12 PERCENT DURING 1978 EVEN THOUGH ITS FIRST QUARTER 1977 LEVEL WAS BELOW THE 1976 AVERAGE LEVEL.

3. THE BALANCE OF PAYMENTS IN THE CENTRAL CASE IS FORECAST TO DEVELOP AS:

(MILLIONS OF POUNDS)

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SP-02 LAB-04 EPG-02 SIL-01 OMB-01 NSC-05 SS-15
STR-04 CEA-01 L-03 H-02 PRS-01 PA-02 INT-05
FEAE-00 ARA-10 AF-10 AGRE-00 /145 W
-----031658Z 056535 /46

R 031628Z JUN 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 4702
TREASURY DEPT WASHDC
INFO AMEMBASSY BONN
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	VISIBLE TRADE		INVISIBLE CURRENT		
	IMPORTS	EXPORTS	BALANCE	BALANCE	BALANCE
1976	28,886	25,294	.3.592	2.169	-1.423
1977	33,821	31,181	-2 640	3,057	417
1978	36,228	34,267	-1.961	3.238	1,277

VOLUME OF

	VISIBLE TRACE,		AVERAGE VALUES OF	
	(MILLIONS OF OO.NDS	VISIBLE TRADE		
	1970 PRICES)	(1970 EQUALS 100)		
	IMPORTS	EXPORTS	IMPORTS	EXPORTS

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1976	10,930	11.036	264.3	229.2
1977	11,367	11.517	297.5	270.7
1978	11,558	11.731	313.4	292.1

..TERMS . OF TRADE (A) EFFECTIVE EXCHANGE RATE (B)

1976	80.4	66.3
1977	80.6	62.7
1978	80.6	62.7

(A) - RATIO OF BASE-WEIGHTED PRICES (EXCLUDES EFFECTS
OF CHANGING OIL TRADE)

(B) - AS CALCULATED BY IMF.

4. THE VOLUME OF EXPORTS IS FORECAST TO RISE BY 3 PERCENT IN 1977, AND 1 PERCENT IN 1978 AS THE FIXED EXCHANGE RATE ASSUMPTION COMBINES WITH CONTINUING INFLATION TO REDUCE THE U.K.'S INTERNATIONAL COMPETITIVENESS. IMPORTS ARE FORECAST TO INCREASE BUT BY 1 PERCENT IN 1977 AND 3 PERCENT IN 1978. THE 1977 INCREASE REQUIRES IN FACT A FALL IN IMPORT VOLUME DURING THE YEAR FROM ITS FIRST QUARTER LEVEL. IF THE EFFECTS OF CURRENT TRANSACTIONS IN NORTH SEA OIL ARE REMOVED, NIESR ESTIMATES THAT THE CURRENT ACCOUNT DEFICIT WOULD GROW TO 1.8 BILLION POUNDS IN 1977 AND 2.3 BILLION POUNDS IN 1978.

5. NIESR BELIEVES THAT AN INCREASE OF 20 PERCENT IN AVERAGE EARNINGS WOULD SUBSTANTIALLY ALTER CONDITIONS OF THEIR FORECASTS. CASH LIMITS WOULD REDUCE THE REAL VOLUME OF GOVERNMENT EXPENDITURE. A FAILURE IN INCOMES POLICY WOULD LEAD TO A CRISIS OF CONFIDENCE. HENCE TO A RUN ON STERLING, AND AN IRRESISTIBLE DOWNWARD PRESSURE ON THE EXCHANGE RATE. THIS DECLINE IN THE EXCHANGE RATE IS RESOON-SIOLE DOR TNE UNUSUAL IMPROVEMENT IN EXPORT PERFORMANCE BETWEEN THE LOW AND HIGH EARNINGS FORECASTS. HIGHER PRICES ARE SEEN TO FOLLOW HIGHER UNIT LABOR COSTS WITH A LAG, REDUCING UNIT PROFITS HENCE REDUCING STOCKBUILDING AND REAL INVESTMENT. HIGHER PRICES ARE ASSUMED TO INDUCE A FALL IN THE CONSUMPTION RATIO. FISCAL DRAG WILL

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ERODE PERSONAL DISPOSABLE INCOME.

6. DIFFERENCES BETWEEN THE 10 AND 20 PERCENT (LOW..ARD
'HIGH') GROWTH IN AVERAGE EARNINGS CASES EMERGE ONLY WITH
TIME. NIESR CONSEQUENTLY CHOOSES THE LST HALF OF 1979 TO
COMPARE THE TWO FORECASTS. A MARGINALLY LONGER FORECAST
PERIOD THAN THAT USED IN THE CENTRAL FORECAST

PERCENTAGE CHANGE IN VOLUME ON YEAR EARLIER.

UNLESS OTHERWISE STATED

	LOW	HIGH
GDP	2	- 1/2
CONSUMERS' EXPENDITURE	1-1/2	- 1/2
PUBLIC AUTHORITIES' CURRENT SPENDING	1/2	-2
EXPORTS OF GOODS AND SERVICES	3	5
IMPORTS OF GOODS AND SERVICES	1-1/2	1-1/2
PUBLIC INVESTMENT	-2	-4
PRIVATE INVESTMENT	4-1/2	-1
CONSUMER PRICE INDEX	7	16-1/2

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LAB-04 SIL-01 L-03 H-02 PRS-01 PA-02 FEAE-00
INT-05 ARA-10 AF-10 AGRE-00 /145 W
-----031658Z 056582 /46

R 031628Z JUN 77
FM AMEMBASSY LONDON
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TREASURY DEPT WASHDC
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LEVEL. MILLIONS	LOW	HIGH
UNEMPLOYMENT	1.7	2.0
LEVEL AT ANNUAL RATE, POUNDS BILLIONS		
CURRENT BALANCE	2.8	3.8

DOLLARS

EXCHANGE RATE 1.71 1 54

ANNUAL RATES, POUNDS BILLIONS

PSBR 6 3

GROSS TRADING PROFITS OF COMPANIES 19 14

PERCENT

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CONSOL RATE 14 16

7. REAL GDP IN THE OECD IS EXPECTED TO INCREASE 4.4 PERCENT IN 1977 WITH CONSUMER PRICES INCREASING 8.7 PERCENT WORLD TRADE IS FORECAST TO INCREASE 7 PERCENT THIS YEAR AND THE FOLLOWING CURRENT ACCOUNT(A) POSITIONS TO EMERGE:

(BILLIONS OF SDR.S)

1975 1976(B) 1977(C)

TOTAL OECD - 4 21 -28

OTHER DEVELOPED COUNTRIES(D) - 4 - 3 - 4

OIL EXPORTERS(B) 30 38 40

OTHER DEVELOPING COUNTRIES(B) -18 -14 .11

CENTRALLY PLANNED ECONOMIES(B) 4 - 3

(A) GOVERNMENT TRANSFERS ABOVE THE LINE

(B) ESTIMATE

(C) FORECAST

(D) ALGERIA. BAHRAIN. ECUADOR. GABON INDONESIA. IRAN'

IRAQ. KUWAIT. LIBYA. NIGERIA. OMAN. QATAR. SAUDI

ARABIA. TRINIDAD AND TOBAGO, UAE. VENEZUELA.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: DATA, ECONOMIC CONDITIONS, ECONOMIC STABILITY, ECONOMIC REPORTS
Control Number: n/a
Copy: SINGLE
Sent Date: 03-Jun-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: n/a
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment:
Disposition Date: 01-Jan-1960 12:00:00 am
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977LONDON09274
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D770198-0882
Format: TEL
From: LONDON
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770694/aaaaddy.tel
Line Count: 311
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 0c60c785-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 20-Oct-2004 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2290391
Secure: OPEN
Status: NATIVE
Subject: NIESR FORECAST AND APPRAISAL OF THE U.K. ECONOMY UNCLASSIFIED UNCLASSIFIED
TAGS: ECON, UK, NIESR
To: STATE TRSY
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/0c60c785-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009